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THE DIRECTOR OF CENTRAL INTELLIGENCE

WASHINGTON, D.C. 20505

NIC #01787-84
19 March 1984

National Intelligence Council

MEMORANDUM FOR: Director of Central Intelligence
Deputy Director of Central Intelligence

FROM: Maurice C. Ernst
NIO for Economics

SUBJECT: NSC Meeting on Iran-Iraq Energy Issues

1. The purpose of the NSC meeting is to establish some basic guidelines on which to base US foreign policy and economic actions in the event of a Persian Gulf supply interruption. The main issues for decision concern:

- o How should the US approach triggering the IEP sharing system in the event of a severe disruption?
- o To what degree should we seek consultation or coordination with our Allies on stock draws?
- o Should the US support coordinated international action to influence this market?

On each issue the options range from little or no US Government action (letting the market do the job) to various forms of joint action and coordination with other nations.

2. In our opinion, the issues on which the NSC is asked to focus basically address how best to minimize the impact of a given disruption on the world oil market. The Administration's main objective is to avoid a recurrence of the enormous price increases that occurred in 1979 in response to a very small world oil shortage. Although this is certainly an important objective, even more important are two types of policy action which are only briefly mentioned in the attached papers. These are:

- o What the US can do to prevent a supply disruption in the first place; and
- o What actions the US can take to minimize the size of any shortfall and its duration.

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3. The NSC study does not systematically review US diplomatic, economic, and military initiatives aimed at preventing an Iraqi escalation of the war which would threaten Iranian oil supplies, or an Iranian response which could threaten Gulf oil supplies. Up to now, both the Iraqis and the Iranians have been cautious in their actions, if not in their statements. Iraq will probably attack Iranian oil exports if its military situation looks desperate. But so far it is not, and US support for any Iraqi oil export pipelines, as well as continued large-scale Saudi assistance to Iraq, may prevent the worst from happening. These questions are being addressed in the CCPG, but we have not seen any paper.

4. Just as important is US deployment of military forces in the area, both to dissuade Iranian attacks and to deal with them if they occur. Working with the Saudis and Kuwaitis to increase oil industry security and to protect and rebuild facilities if an attack occurs obviously are also of critical importance, and little is said about the subject. DoD is examining these questions, but we are not aware that any interagency process is under way.

5. From an intelligence point of view, you may wish to make the following points:

- o Although Southern Gulf oil facilities are highly vulnerable to attack, the chances are small that the Iranians would succeed in damaging them so severely as to cause an extended reduction in Saudi and Kuwaiti exports once the smoke had cleared. Most of the critical facilities would have to be largely destroyed to cause a big oil supply shortfall.
- o Oil tankers in the Persian Gulf are highly vulnerable, however, to all kinds of attacks. Reopening the Straits would not make the Gulf safe for tankers. A large US naval presence might be required to do the job.
- o If there were major attacks against oil targets in the Southern Gulf, a great deal of uncertainty would prevail about the extent of the damage and its market impact. Initially oil prices would probably shoot up rapidly. The US Government could help calm the market by disseminating more accurate information. The Intelligence Community can help in this regard.
- o Since we believe that the great majority of possible disruptions would have a relatively small and short-lived impact on world oil supplies, it makes sense to focus policy reactions on calming the market and releasing stocks, rather than on triggering major coordinated policy moves, such as under the IEA. The IEA should be activated only if the disruption is known to be large and likely to continue for at least several months.

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6. Attached are the following materials:

A. The NSC policy papers.

B. A memorandum from [redacted] "Energy Emergency Preparedness," with which I concur.

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C. The recent Interagency Assessment on the Iran-Iraq war and its effects.

D. An uncoordinated draft of the sections of the forthcoming SNIE

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E. Selected IEEW articles and an IA from OGI International Oil Market Outlook: Midyear Assessment.

F. Some background statistics on the oil market.


Maurice C. Ernst

Attachments,
As stated

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